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# ACCA

# Financial Reporting
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# Mock B – Answers

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# SECTION A

## 1 8.4¢ and 9.8¢

Basic Earnings per Share: 565,000/(6,000,000 + 750,000) = 8.4¢

Comparative: 11c × $^{8}/_{9}$ = 9.8¢

Bonus issues are treated as if the shares had always been in issue. The bonus issue would have increased the number of shares in issue by 6m × $^{1}/_{8}$ = 750,000 shares.

The bonus fraction is the number of shares after the bonus issue/number of shares before the bonus issue = $^{9}/_{8}$. Comparatives are restated by multiplying the prior year EPS figure by the inverse of the Bonus Fraction, i.e. $^{8}/_{9}$.

## 2 $578,000

| | $ |
|---|---|
| Cost of investment: | |
| Share exchange ((1,000,000 × 80%) × $^{2}/_{5}$) × $5.40 | 1,728,000 |
| Fair value of NCI | 850,000 |
| | 2,578,000 |
| Less: net assets at acquisition | (2,000,000) |
| Goodwill on acquisition (1.10.X8) | 578,000 |

## 3 Record the net assets at their values shown above and credit profit or loss with $1.3 million

| | $000 |
|---|---|
| Cost of investment | 6,000 |
| Net assets at acquisition | (7,300) |
| Bargain purchase (negative goodwill) | 1,300 |

Negative goodwill is taken as a gain to the statement of profit or loss.

## 4 An investment of 30% of the ordinary shares in Akasma. Prima has one representative on Akasma's board of directors

Significant influence is assumed with a shareholding of between 20 and 50% and is confirmed as Prima is involved in Akasma's decision-making with a seat on the board of directors. Akasma should be equity accounted in the consolidated financial statements.

In relation to Artim, Prima holds 40% of the shares so significant influence would be assumed, but the other 60% are owned by one company which in turn will control Artim, therefore Prima has no significant influence.

For Adora, Prima holds less than 20% of the shares, so would be assumed to have no significant influence over Adora so there is no need to equity account or consolidate. This investment would be held as a financial instrument.

For Ajax, 35% of the preference shares gives no influence or control over Ajax so there is no need to equity account or consolidate. This investment would be held as a financial instrument.

## 5 Operating activities: £150,000 deducted, Investing activities: $500,000 inflow

The figure under operating activities will represent the adjustment to profit before tax, and is therefore the non-cash grant amortisation, calculated below. The figure under investing activities will represent the actual cash received during the year, given in the question as $500,000.

| | $000 | | $000 |
|---|---|---|---|
| **(β) Grant amortisation** | **150** | b/f NCL government grants | 1,100 |
| | | b/f CL government grants | 650 |
| | | **Grant received** | **500** |
| c/f NCL government grants | 1,250 | | |
| c/f CL government grants | 850 | | |
| | 2,250 | | 2,250 |

## 6 (ii), (iii) and (iv) only

The current ratio would not be affected as it considers current assets and liabilities. The revaluation would increase the equity section of the statement of financial position, and affect any ratios that include equity or capital employed.

## 7 Restating the prior year earnings per share figure following a rights issue of shares during the current year

Restating the earnings per share will enable a like-for-like comparison.

## 8 Separately disclosing discontinued operations within the financial statements

Information is relevant if it has predictive or confirmatory value. Disclosing discontinued operations enables users to identify those transactions/events that will not continue in subsequent accounting periods, so has predictive value.

## 9 $4,937,600

Inventory should be valued at the lower of cost and net realisable value (NRV). In this case the damaged items have a NRV below cost, and this reduction in value needs to be reflected within the final total inventory value.

| | $ |
|---|---|
| Cost of damaged goods | 390,000 |
| Plus normal mark-up 20% | 78,000 |
| Normal selling price | 468,000 |
| Less discount 30% | (140,400) |
| Net realisable value | 327,600 |

Inventory needs to be written down by the difference between cost and NRV, $62,400.

Final value of inventory is therefore 5,000,000 – 62,400 = **$4,937,600**.

## 10 $55,500

1 Depreciation – 200,000/5 years = **$40,000**

2 Lease interest:

| Year | b/f | Interest 10% | c/f |
|---|---|---|---|
| 20X9 | 155,000 | **15,500** | 170,500 |

Therefore total charge = $40,000 + $15,500 = **$55,500**.

## 11 $1,300,000

$19,500,000/15 years = **$1,300,000**

The original cost of the property is irrelevant to the calculation, which should be based on the latest valuation of the **building** and the latest estimate of remaining life.

## 12 The asset's market value has declined more than would be expected from the passage of time, changes in the economic environment of the business in which the asset is employed

Damage/obsolescence and a change in the way an asset is used are **internal** indicators that an entity's assets may have become impaired. Market values and economic environment changes are **external** factors.

## 13 Borrowing costs can continue to be capitalised once activities to prepare the asset for use are complete, if the asset is not yet in use

Borrowing costs should be capitalised during the period of construction of a qualifying asset. If construction is halted, either temporarily or permanently, the capitalisation also ceases. Any income arising from temporary investment of surplus funds during the period of construction is deducted from the borrowing costs capitalised.

## 14 $3 million

| | | $000 |
|---|---|---|
| Carrying amount b/f | ($20m – $4m) | 16,000 |
| Amortisation to 31 March 20X9 | ($20m/5 years) | (4,000) |
| Carrying amount at 31 March 20X9 | | 12,000 |
| Fair value at 31 March 20X9 | | (9,000) |
| Impairment | | **3,000** |

## 15 Treated as an adjusting event in the financial statements

Adjusting events are those events that arise between the reporting date and the date on which the financial statements are authorised for issue, and which provide additional evidence of conditions that existed at the reporting date. The fraud was committed before the reporting date, so the financial statements will be adjusted.

# SECTION B

## 16 $29 million

| | | |
|---|---|---|
| Cost of investment | | $m |
| Cash | | 70 |
| Deferred consideration | $8.47 \times 1/1.1^2$ | 7 |
| Non-controlling interest | Per question | 24 |
| **Net assets** | | |
| Share capital | 20 | |
| Retained earnings | 48 | |
| Fair value adjustment | 4 | |
| ($12m – $8m) | ——— | |
| | | (72) |
| | | ——— |
| | | 29 |
| | | ——— |

## 17 It is credited to profit or loss

The gain on bargain purchase reflects the fact that nets assets have been acquired at a price below their fair value. As such, this represents a realised gain and is included within the profit or loss for the year.

## 18 $46.8 million

| | | $m |
|---|---|---|
| Cost of investment | 50m × 30% × $3 | 45.0 |
| Post-acquisition profit | $24 \times {}^{3}/_{12} \times 30\%$ | 1.8 |
| | | ——— |
| | | 46.8 |
| | | ——— |

The investment in Aaron is measured at initial cost plus the parent's share of post-acquisition profit. Retained earnings at the year-end are irrelevant here because we are told the profit earned during the year.

## 19 $243.8 million

| | | $m |
|---|---|---|
| Payne | | 180 |
| Scannell | | 60 |
| Fair value adjustment | ($12m – $8m) | 4 |
| Fair value depreciation | 4 × 1/20 | (0.2) |
| | | ——— |
| | | 243.8 |
| | | ——— |

## 20 Write off as an expense in the statement of profit or loss

Professional fees incurred should be written off as an expense in the statement of profit or loss.

## 21 Plant carrying amount: $90,000/Revaluation surplus: $30,000

| | | Plant carrying amount | Revaluation surplus |
|---|---|---|---|
| | | $000 | $000 |
| 1 December 20X5 Cost | | 150 | |
| Depreciation to 1 June 20X8 | $150,000 × 2½/5 | (75) | |
| Carrying amount 1 June 20X8 | | 75 | |
| Revaluation gain | (balancing figure) | 30 | 30 |
| Fair value 1 June 20X8 | | 105 | |
| Depreciation to 30 November 20X8 | $105,000 × 6 months/ 3½ years | (15) | |
| Carrying amount 30 November 20X8 | | 90 | 30 |

## 22 $103,480

| | Cash flow | Discount factor | Present value |
|---|---|---|---|
| Year ended | $000 | at 8% | $ |
| 30 November 20X9 | 44,000 | 0.93 | 40,920 |
| 30 November 20Y0 | 36,000 | 0.86 | 30,960 |
| 30 November 20Y1 | 40,000 | 0.79 | 31,600 |
| | | | 103,480 |

## 23 $280,000

| | Carrying amount before impairment | Impairment | Carrying amount after impairment |
|---|---|---|---|
| | $000 | $000 | $000 |
| Goodwill | 200 | 200 | – |
| Factory building | 400 | 80 | 320 |
| **Plant** | **350** | **70** | **280** |
| Receivables and cash | 250 | – | 250 |
| | 1,200 | 350 | 850 |

Impairment is first allocated against goodwill, then pro-rata against the remaining assets, excluding cash and receivables which are outside the scope of IAS 36. The goodwill impairment accounts for $200,000 of the total impairment of $350,000, leaving $150,000 to be apportioned between the factory building and plant, based on their carrying amounts before the impairment.

The impairment charged against the plant is calculated:

$150,000 × 350/(350 + 400) = $70,000

## 24 Statements (1) and (3)

Statement 1 is the definition of a cash generating unit. Cash generating units are considered when the recoverable amount of an individual asset cannot be determined. The assets comprising a cash generating unit must be considered consistently when comparing carrying amount and recoverable amount, so Statement 2 is untrue.

## 25 Its carrying amount exceeds its recoverable amount, and the recoverable amount is the higher of its fair value less costs of disposal and its value in use

An asset is impaired when its carrying amount is overstated. The recoverable amount represents the cashflow from the most advantageous use of the asset, hence the higher of fair value less costs of disposal and value in use.

## 26 Only (1), (2) and (4)

A contract to exchange financial instruments with another entity under conditions which are potentially unfavourable is an example of a financial liability.

## 27 $9,650 gain

The investment is speculative, so the election to measure at Fair Value through Other Comprehensive Income is not available, and the investment would be carried at Fair Value through Profit or Loss. Transaction costs are therefore not included within the initial recognition value, but instead are taken to profit or loss as an expense of **$350**.

Cost of shareholding is 10,000 × $3.50 = $35,000

Fair value at 31 December 20X5 10,000 × $4.50 = $45,000

Gain = $45,000 – $35,000 = **$10,000**

**Net impact in the statement of profit or loss = $10,000 gain less $350 expense = $9,650.**

## 28 $1.4 million

The finance cost would be calculated using the effective rate of interest for six months.

$40 million × 7 × $^{6}/_{12}$ = $1.4 million

## 29 $17.6 million

The standard selling price for the machine is $20.5 million and for the maintenance $1.5 million per annum, a total standard sales value of $25 million. The agreed selling price for the package is $20 million, a discount of 20% against the standard price. This discount is apportioned between the performance obligations (delivery and maintenance) on the basis of standard price.

| | $000 | |
|---|---|---|
| Machine: $20.5m less 20% | 16,400 | |
| Maintenance: $1.5m × 3 years less 20% | 3,600 | ($1.2m per annum) |
| Agreed selling price | 20,000 | |

Revenue is recognised on the basis of satisfaction of performance obligations. By 31 December 20X5 Stankovic has delivered the machine and provided one year of maintenance. The total revenue to be recognised in the year is $16.4m goods + $1.2m maintenance = **$17.6m**.

## 30 Allocate the performance obligations

The five stages of revenue recognition under IFRS 15 are to:

(i) Identify the contract

(ii) Identify the performance obligations under the contract

(iii) Identify the contract price

(iv) Allocate the price to the performance obligations

(v) Recognise revenue as the performance obligations are satisfied

# SECTION C

## 31 LINGU CO

### (a) Loss on disposal

The loss on disposal in the consolidated financial statements is:

| | $m | |
|---|---|---|
| Proceeds | 50.0 | ½ |
| Less: net assets at disposal | (75.0) | 1 |
| Less: carrying amount of goodwill **(W1)** | (6.8) | ½ |
| Loss on disposal | (31.8) | |

**(W1) Goodwill**

| | $m | |
|---|---|---|
| Fair value of investment | 87.0 | ½ |
| Less net assets at acquisition | (70.0) | ½ |
| Goodwill at acquisition | 17.0 | |
| Goodwill impairment (60%) | (10.2) | 1 |
| Carrying amount of goodwill | 6.8 | |

### (b) Ratios and commentary

| **Ratios** (½ mark each) | 20X6 | 20X5 |
|---|---|---|
| **Profitability ratios** | | |
| Gross profit margin | 43.8% | 48.5% |
| | ((320/730) × 100) | ((330/680) × 100) |
| Operating profit margin | 22.9% | 35.1% |
| | ((167/730) × 100) | ((239/680) × 100) |
| Return on capital employed | 9.3% | 13.1% |
| (operating profit/equity + NCL) | (167/(1,552 + 250)) | (239/(1,445 + 375)) |
| **Liquidity ratios** | | |
| Current ratio | 3.1:1 | 0.8:1 |
| | (280/90) | (312/400) |
| Gearing (debt/debt + equity) | 13.9% | 20.6% |
| | (250/(1,552 + 250)) | (375/(1,445 + 375)) |

**Financial performance**

Consolidated revenue has increased from 20X5 to 20X6, despite the loss of Ravi Co's significant customer three months into the financial year. This suggests that Ravi Co's lost revenue has been more than compensated for by an increase in the revenue of either Lingu or its other subsidiary, or both. Despite this increase in the group's revenue, the gross profit margin has fallen by 4.7%, probably due to the poor financial performance of Ravi Co. It could also be that the group's sales mix has changed, leading to a lower overall margin. [1 mark]

As sales of Ravi Co represent 17% of the total group sales, its poor performance will also have affected the group operating margin. Operating profit margin has dropped significantly from 35.1% to 22.9%. Administrative expenses have almost doubled from $58m for the year ended 30 April 20X5 to $115m for the year ended 30 April 20X6. Part of this increase will be due to the $31.8m loss on disposal of Ravi Co, which has been charged to administrative expenses, which will also have increased as a result of the $38m staff redundancy costs. [1 mark]

ROCE has fallen from 13.1% to 9.3%, but this figure is hard to interpret, as the profit includes the trading loss of Ravi Co plus the loss on disposal, but the capital employed figure does not include the capital of Ravi Co due to its disposal at the year end. The operating loss made by Ravi Co of $43m plus the loss on disposal of $31.8m will have reduced operating profit. The removal of these figures would result in a group ROCE of 12.9% ($167m + $43m + $31.8m)/(($1,552m + $43m + $31.8m) + $250m) which is more in line with the 20X5 figure, although it is an over-simplification. [1 mark]

**Financial position**

The current ratio shows considerable improvement for the year ended 20X6, following the disposal of Ravi Co. The group was in a net current liability position at the end of 20X5, and this has now become a more positive net current asset position. [1 mark]

This suggests that Ravi Co may have had high levels of current liabilities at 30 April 20X5, perhaps including a large bank overdraft. It would seem that the sale of Ravi Co has improved the liquidity of the group. [1 mark]

The current ratio improvement will also have been affected by the movements in inventory. The value of group inventory has fallen from 20X5 to 20X6 by $33m, but this excludes Ravi Co's 20X6 inventory of $105m. It is difficult to form any definitive judgement without knowing the value of Ravi Co's inventory at 30 April 20X5, but if we include Ravi Co's 20X6 inventory within the group, then the combined inventory has increased from $195m to $267m, a rise of 37%. Assuming a similar increase across the group then this is something requiring further investigation. [1 mark]

It should be noted that 20X6 group current assets of $280m will include the $50m consideration received for the sale of Ravi Co. This could be used to settle some of the long-term debt. Non-current liabilities have already decreased by at least $125m. There is no information about the long-term loans of Ravi Co, but the disposal of Ravi Co may be responsible for this fall. [1 mark]

Gearing has been reduced during the year from 20.6% to 13.9% but, without further information on Ravi Co's non-current liabilities, it is not possible to tell if this is a result of the disposal or whether Lingu Co has simply repaid debt during the year. [1 mark]

**Conclusion**

Despite the inclusion of Ravi Co's reduced revenue in the consolidated statement of profit or loss does, the group has managed to increase overall revenue by 7%, and now that Lingu Co has disposed of this underperforming subsidiary, it might be able to better control costs, improving both gross and operating profit margins. Ravi Co appears to have been a drain on the liquidity of the group, and the position of the group appears to be much healthier following the disposal of Ravi Co. [1 mark]

**(c) Comparability**

As the sale of Ravi Co took place on 30 April 20X6, both 20X5 and 20X6 include a full year's trading for Ravi Co, so the statement of profit or loss would seem to be comparable for each year. However, the consolidated administration expenses for 20X6 include the loss on disposal of $31.8 million, so this will need to be adjusted for comparison purposes. [1 mark]

The main area where comparability will be affected is within the statement of financial position, because the 20X6 consolidated statement of financial position (CSFP) will exclude the assets and liabilities of Ravi Co. Any ratios for 20X6 which use CSFP figures will not be directly comparable with those for 20X5. This will include current ratio and gearing ratio, but most significantly return on capital employed, where profit will be included but capital employed will not be, leading to distortion. [1 mark]

This lack of comparability is one of the reasons that IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* was introduced, to show the discontinued operation separately in order to better measure the performance and position of the continuing business. Despite the fact that, according to the question, the sale did not meet the necessary definition, comparability would have been improved by applying the IFRS 5 treatment. [1 mark]

| **Marking scheme** | | |
|---|---|---|
| | | Marks |
| (a) | Disposal loss | 4 |
| (b) | Ratio calculations | 5 |
| | Analysis | 8 max |
| (c) | Comparability | 3 |
| **Total** | | **20** |

## 32 CHESTNUT

### (a) Adjusted profit for the year ended 31 March 20X5

| | | $000 | |
|---|---|---|---|
| Draft profit per trial balance | | 40,125 | ½ |
| Depreciation | – Property (W1) | (3,000) | ½ |
| | – Plant and equipment (W1) | (9,500) | ½ |
| Finance costs | – Convertible loan (W2) | (698) | 1 |
| | – Preference shares (W3) | (5,200) | 1 |
| Income tax expense (W4) | | (3,075) | W |
| Profit for the year | | 18,652 | |

### (b) Statement of financial position as at 31 March 20X5

| | $000 | | $000 | |
|---|---|---|---|---|
| Non-current assets | | | | |
| Property (W1) | | | 62,000 | W |
| Current assets | | | | |
| Inventory | 35,250 | ½ | | |
| Trade receivables | 41,375 | ½ | | |
| Bank | 34,350 | ½ | | |
| | 110,975 | | | |
| Asset held for sale (W1) | 28,500 | 1 | | |
| | | | 139,475 | |
| | | | 201,475 | |

| | | | | |
|---|---|---|---|---|
| Equity | | $000 | $000 | |
| Ordinary share capital | | | 42,000 | ½ |
| Share premium | | | 8,000 | ½ |
| Convertible option (W2) | | | 1,272 | ½ |
| Revaluation surplus (9,000 + 5,000 (W1)) | | | 14,000 | 1 |
| Retained earnings (12,125 + 18,652 – 12,500) | | | 18,277 | 1 |
| | b/f profit dividend | | | |
| | | | 83,549 | |
| Non-current liabilities | | | | |
| 6% preference shares (W3) | | 54,200 | W | |
| Convertible loan (W2) | | 9,026 | W | |
| Deferred tax (W5) | | 7,000 | 1 | |
| | | | 70,226 | |
| Current liabilities | | | | |
| Taxation (W4) | | 5,700 | ½ | |
| Trade payables | | 42,000 | ½ | |
| | | | 47,700 | |
| | | | 201,475 | |

**(c) Earnings per share**

| | | |
|---|---|---|
| Profit for the year/weighted average number of shares | 18,652/39,333 (W6) = **47.4¢** | |
| | 1 | W |

**Workings**

**(W1) Non-current assets**

***Tutorial note:***

*The property is to be revalued at the year-end, so depreciate first and then revalue.*

| | Property | | Plant and equipment |
|---|---|---|---|
| | $000 | | $000 |
| Cost/valuation 1 April 20X4 | 60,000 | | 60,000 |
| Accumulated depreciation 1 April 20X4 | | | (22,000) |
| | | | 38,000 |
| Depreciation: $60,000 × $^{1}/_{20}$ | (3,000) | ½ | |
| $38,000 × 25% | | | (9,500) |
| | 57,000 | | 28,500 |
| Revaluation gain: other comprehensive income | 5,000 | ½ | |
| Valuation 31 March 20X5 | 62,000 | | |

As plant is held for sale, transfer to current assets and measure at the lower of carrying amount ($28,500) and fair value less costs to sell ($32,000). Therefore carry in **current assets at $28,500**.

**(W2) Convertible loan note**

***Tutorial note***

*The convertible loan note needs to be split into its liability and equity components.*

*The liability component is calculated by taking the present value of the payments to be made, discounted at the market rate of a similar loan note without conversion options.*

*The payments will therefore be discounted at 8%.*

| Year ended 31 March | Cash flows | Factor at 8% | Present value |
|---|---|---|---|
| | $000 | | $000 |
| 20X5 interest (10,000 × 4%) | 400 | 0.93 | 372 |
| 20X6 interest | 400 | 0.86 | 344 |
| 20X7 interest | 400 | 0.79 | 316 |
| 20X8 interest + capital redemption | 400 + 10,000 | 0.74 | 7,696 |
| Total value of liability component | [1 mark] | | 8,728 |
| Equity component (balancing figure) | | | 1,272 |
| Proceeds of issue | | | 10,000 |

The initial double entry is:

| | $000 |
|---|---|
| Dr Cash | 10,000 |
| Cr Liability | 8,728 |
| Cr Equity | 1,272 |

The liability element is then carried at amortised cost as shown below. [½ mark]

| Year | b/f | Interest 8% | Interest paid 4% | c/f |
|---|---|---|---|---|
| | $000 | $000 | $000 | $000 |
| 20X5 | 8,728 | 698 | (400) | 9,026 |
| | | **(finance costs – adjust profit)** | | **(non-current liability in SFP)** |

**(W3) Preference shares**

| Year | b/f | Interest @ 10% | Payment | c/f |
|---|---|---|---|---|
| | $000 | $000 | $000 | $000 |
| 31 March 20X4 | 52,000 | 5,200 | (3,000) | 54,200 |
| | ½ | | 1 | |
| | | **To finance costs** | **Per trial balance** | **To NCL** |

**(W4) Income tax expense**

| | $000 | |
|---|---|---|
| Year-end estimate, per note (iv) | 5,700 | ½ |
| Under provision, per trial balance | 875 | ½ |
| Decrease in deferred tax (W5) | (3,500) | ½ |
| | 3,075 | |

**(W5) Deferred tax**

| | $000 |
|---|---|
| Deferred tax c/f **(Non-current liability on SFP)** | 7,000 |
| Deferred tax b/f | (10,500) |
| Decrease in deferred tax | (3,500) |

**(W6) Weighted average number of shares**

| | No of shares | | Proportion | | Weighted average |
|---|---|---|---|---|---|
| Brought forward | 34,000 | ½ | × 4/12 | ½ | 11,333 |
| Issue | 8,000 | | | | |
| Trial balance | 42,000 | ½ | × 8/12 | ½ | 28,000 |
| | | | | | 39,333 |

| ACCA marking scheme | | |
|---|---|---|
| | | *Marks* |
| (a) | Profit adjustments | |
| | Draft profit | ½ |
| | Property depreciation | ½ |
| | Plant and equipment depreciation | ½ |
| | Convertible loan finance cost | 1 |
| | Preference shares finance cost | 1 |
| | Income tax (½ under provision, ½ current year, ½ deferred tax) | 1½ |
| | | **5** |
| (b) | Statement of financial position | |
| | Property | 1 |
| | Inventory | ½ |
| | Receivables | ½ |
| | Bank | ½ |
| | Asset held for sale (0 if in PPE, 0 if $32,000) | 1 |
| | Share capital | ½ |
| | Share premium | ½ |
| | Conversion option | ½ |
| | Revaluation surplus | 1 |
| | Retained earnings | 1 |
| | Convertible loan (1 for initial liability, ½ for adjustment) | 1½ |
| | Redeemable preference shares | 1½ |
| | Deferred tax | 1 |
| | Trade payables | ½ |
| | Taxation | ½ |
| | | **12** |
| (c) | Earnings per share | |
| | Calculation (own figure rule) | 1 |
| | Number of shares | 1 |
| | Weighting (months) | 1 |
| | | **3** |
| **Total** | | **20** |

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